ALLIANCE FOREST PRODUCTS INC

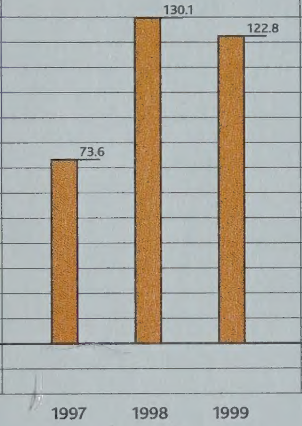
ANNUAL REPORT 1999

ALLIANCE
Forest Products Inc.
5 years 1994 1999

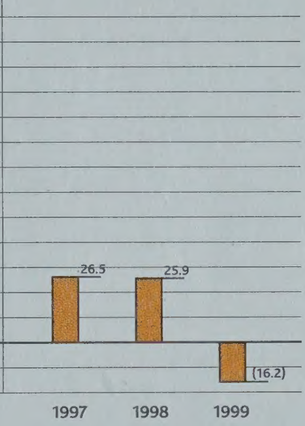

BAIE TRINITÉ
GIRARDVILLE
DOLBEAU-MISTASSINI
ST-FÉLICIEN
DONNACONA
RIVIÈRE-BLEUE
DÉGELIS
PRICE
LAC-DES-AIGLES
BAKER BROOK
COOSA PINES
WESTOVER

Sales
(in millions of dollars)

Cash flow from operations
(in millions of dollars)



Net earnings (net loss)
(in millions of dollars)



All graphs are printed on Eminence Plus paper

Highlights

Alliance Forest Products Inc. is an integrated forest products company that specialises in the production and marketing of lumber and related products, pulp, newsprint, and uncoated groundwood papers. Dedicated, flexible and experienced, our team is committed to manufacturing high-quality, value-added products at competitive prices. The quality of our products is matched only by the excellence of our service – we listen to our customers' needs, we work to improve their competitiveness and we deliver what they want, right on schedule.

(in millions of CAN$, except for amounts per share and statistics)

	1999	1998	1997
Sales	1,052.7	1,085.1	823.3
Operating earnings	9.0	94.2	58.8
Net earnings (loss)	(16.2)	25.9	26.5
Cash flow from operations	122.8	130.1	73.6
Total assets	1,734.4	1,771.8	1,688.9
Per common share			
Net earnings (loss)	(0.44)	0.68	0.79
Book value as at December 31	25.35	25.09	24.35
Share price as at December 31	17.05	14.60	23.50
Return on shareholders' equity (%)	1.81	2.77	7.56

Number of shares issued and outstanding at December 31, 1999: 35.2 million

Changes in share price and volumes traded (January 1 to December 31, 1999)

	Year high	Year low	Close	Volume
Toronto:	20.75	13.85	17.05	35,014,030
New York (US$):	13.88	9.13	11.81	490,000
				35,504,030

Percentage of shares traded (volume of transactions/number of shares issued and outstanding): 101%

In this report, the main units of measurement are metric tonnes and foot board measures (fbm). The latter corresponds to one square foot of lumber one inch thick. Monetary amounts are in Canadian dollars, unless otherwise indicated.

From left to right: Mr. Pierre Monahan and Mr. Robert Després

Message to shareholders

Optimization of production and assets for profitable and sustained growth

1999 saw the start of several projects responding to our strategy, first developed in 1995, of growing our operations in value-added paper products and optimising the Company's operations and assets.

Two projects deserve particular mention. First is the construction, beginning in March 1999, of a new machine for manufacturing high-quality supercalendered papers at the Donnacona, Quebec, mill. This investment, announced during the summer of 1998, will strengthen Alliance Forest Products Inc.'s competitive position in the value-added paper segment, and provide a solid footing for the resurgence of the Donnacona mill, making it one of the cornerstones of our future growth. When started up, paper machine No. 4 will increase the mill's total tonnage and improve the return on capital invested, thanks to its production of exclusive higher-margin papers.

The second major project is the reorganization of operations at the Coosa Pines mill in Alabama. This mill will specialize in producing recycled newsprint and fluff pulp. This project, which is also part of the Company's strategic plan, is the logical follow-up to the investments made in the Dolbeau and Donnacona mills. It includes the termination of the production of groundwood pulp, which will be replaced by de-inked pulp, a change that will significantly reduce the mill's virgin fibre requirements.

These two projects represent another step towards fulfilling our strategic plan, which is designed to concentrate our production of value-added papers at our Canadian mills, while our American facilities, due to its strategic location in the southern U.S., will concentrate on the production of newsprint. In addition, the cost of the paper produced at this mill will position the plant within the first quartile.

Making strategic investments of this magnitude requires access to significant capital and the preservation of a balanced financial structure. Two major transactions – one early in the fiscal year and the other announced last fall – provided funds that could be redirected to these projects.

The first was the January 1999 sale of our Dolbeau cogeneration plant to Boralex Inc. for a consideration of $76 million. However, it was the sale of the Alabama woodlands to John Hancock Financial Services for about $440 million, finalized this past February, that made the largest contribution to increasing cash flow and the Company's liquidity.

This second transaction, which among other things includes a long-term fibre supply agreement at competitive prices, has created value for Alliance Forest Products Inc. shareholders, while allowing the Company to reroute capital to reduce its bank debt, buy back some of its shares and continue modernizing its facilities.

Investments, restructuring of operations, asset sales and ongoing cost-reduction efforts helped us stay on course despite harsh market conditions, early in the year.

In 1999, the weakness of newsprint and pulp prices, more pronounced during the first half of the year, negatively affected the Company's profitability. In early summer, the price of newsprint hit its lowest level in years. Excess newsprint supply, partially the result of the resumption of a major competitor's operations following a prolonged labor conflict, negatively impacted demand, prices and profit margins. The end of the fiscal year was, however, marked by a return to a better-balanced market. The recovery of economic activity in Asia and Europe helped re-establish consumption, which in turn bolstered Canadian exports. Signs of improvement were also seen in the pulp sector during the second half of the year. Demand for fluff pulp firmed as did demand for all grades of pulp, as demand growth combined with production curtailments and shutdowns led to more balanced market conditions. These situations all helped improve prices and, as a result, led to a gradual improvement in the profitability of our operations. The lumber market remained very strong, due to sustained demand.

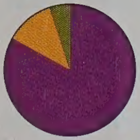
The Company's sales, which topped the $1 billion mark in fiscal 1998, edged down slightly to $1,052.7 million in 1999. The Company recorded a net loss of $16.2 million, or $0.44 per common share, for the year.

Despite some fear about the continuation of expansionist monetary policies by North American and European economies, we remain optimistic for the future. Even though there could be a slowdown in the growth rates of these economies, consumer confidence in North America, reflected among other things in the high number of housing starts and increased advertising expenditures, together with the strength of the Asian economies, should support demand for forest products. The favorable outlook produced by these conditions should help improve the Company's results over the coming quarters.

Because of the weakness of the price of our shares, which traded well below their book value throughout the year, and in an effort to align the financial interests of the Company and those of its shareholders, we repurchased about $50 million worth of shares for cancellation in 1999. In the Company's best interests, we also decided to earmark part of the proceeds of the sale of the Alabama woodlands – about $100 million – for the repurchase of shares via a Modified Dutch Auction, an initiative announced early in fiscal 2000.

Sales by market

1999



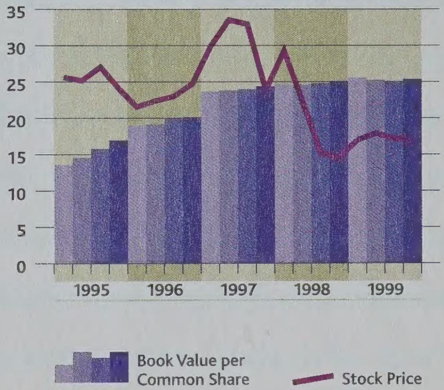
United States	83.0%
Canada	12.0%
Overseas	5.0%

1998

United States	82.0%
Canada	12.2%
Overseas	5.8%

Comparison Between the Stock Price and the Book Value per Common Share

(in dollars)



Alliance Forest Products Inc. is constantly reviewing its innovative forest management practices, which very often go beyond regulatory requirements. In co-operation with other forest users, Alliance Forest Products Inc. actively supports the reform of Quebec's forestry plan, whose priority it is to improve the management of this important collective heritage.

The agreement on export quotas for Canadian lumber to the United States, in effect since 1996, ends in 2001, and Alliance Forest Products Inc. opposes its renewal. We believe that such restrictions amount to ineffectual trade barriers that are detrimental to the development of Canadian forestry companies. In co-operation with other corporate members of our industry, management of Alliance Forest Products Inc. therefore plans to continue its representations to the organizations concerned in order to prevent the renewal of this agreement.

Alliance Forest Products Inc. would be unable to fulfill its mission or achieve its objectives without the constant support and unwavering dedication of its employees. Once again this year, our employees demonstrated total professionalism and we wish to offer them our most sincere thanks. We also wish to take this opportunity of thanking all the members of the Board of Directors, who continued to provide us with the benefit of their valuable advice regarding the Company's operations, development and financial health. The concerted efforts of all of these partners ensured that Alliance Forest Products Inc. continued to provide quality products and services to a constantly growing customer base, whose loyalty is our most important concern.

Robert Després

Chairman of the Board

Pierre Monahan

President and Chief Executive Officer

Coosa Pines, Alabama
Investing for the future

NEWSPRINT AND MARKET PULP

Old newspapers already represent a key raw material at Coosa Pines. The mill's de-inking capacity, currently some 450 tonnes a day, will increase to 1,400 tonnes a day, and the mill will manufacture 100%-recycled newsprint. New, ultra-modern recycling facilities will include drum pulpers, screens and cleaners for high pulp cleanliness, as well as flotation cells for de-inking.

Specialisation in recycled newsprint

The Coosa Pines complex, acquired in 1997, has expanded Alliance Forest Products Inc's presence in the southern United States, one of the rare regions where consumption of newsprint is experiencing relatively strong growth. In 1999, the Company began implementing a strategic plan that will not only reduce the mill's production costs and fully capitalise on its potential, but also bring it into compliance with the Cluster Rules, the new American environmental standards that are being progressively introduced. The main features of this strategic plan are:

- Specialisation of the Coosa Pines mill in recycled newsprint;
- Increase in production capacity;
- Improvement in the mill's environmental performance.

In order to achieve the above strategies, US$170 million will be invested in the mill over the coming years. For newsprint, there will be only recycled pulp produced at Coosa Pines, instead of the current four. The changes will result in significantly reducing per-tonne production costs, and will favourably affect the mill's profitability. The main work to be done will include:

- Increasing de-inking capacity to 1,400 tonnes per day from 450;
- Shutting down the groundwood pulp facilities;
- Converting one specialty machine to newsprint production;
- Increasing the speed of two machines.

Coosa Pines

(Production capacities in metric tonnes)

Paper

Machine	Product	Capacity 2000	Capacity 2003
PM1	Uncoated Groundwood papers	88,000	—
PM1	Newsprint	—	88,000
PM3	Newsprint	149,000	175,000
PM4	Newsprint	156,000	185,000
Total		**393,000**	**448,000**

Pulp

	Product	Capacity 2000	Capacity 2003
	Fluff pulp	235,000	235,000
	SBHK	29,000	—
	Softwood pulp	—	29,000
Total		**264,000**	**264,000**

By combining efforts of reducing production costs with improvements required under the Cluster Rules, and focusing on the production of 100%-recycled newsprint, the Coosa Pines mill has laid the groundwork for increased profitability.

As a result, by 2001 this mill will specialise in producing 100%-recycled newsprint, compared with the current 40% recycled level. In addition, only two types of pulp will be produced instead of the current four, leading to further efficiency gains. In adopting this strategy, Alliance Forest Products Inc. remains faithful to its vocation as an integrated, efficient producer, and to its objective of attaining a critical mass in the newsprint sector. In addition, the Company is maximising the advantages of the Coosa Pines complex, including:

- Its location in a region where demand for newsprint is growing;
- Its proximity to customers, thus minimising freight costs;
- Its access to an abundant supply of old newspapers and magazines.

Pulp: increased efficiency

Alliance Forest Products Inc. is one of North America's large fluff pulp producers, with an annual production capacity of some 235,000 tonnes. Fluff pulp is used in the manufacture of disposable diapers and other personal hygiene products. Most of Alliance Forest Products Inc.'s production is sold under a renewable long-term supply agreement to Kimberly-Clark, for which the Company is the partner of choice. The strategic plan mentioned earlier in this Annual Report calls for the continuation of fluff pulp production. In addition, once the paper plant is converted to the production of newsprint using 100% de-inked pulp, the Company will be able to produce and market an additional 29,000 tonnes of softwood kraft pulp, previously used by the paper mill.

Dolbeau and Donnacona meet the value-added challenge

TOWARDS A LEADING PRODUCT LINE

This fall the Donnacona mill will start up the new No.4 paper machine, which has a 152,000 tonne capacity.

A market-driven strategy

Alliance Forest Products Inc.'s two Quebec paper mills, at Dolbeau and Donnacona, make uncoated groundwood specialty and soft-nip calendered papers. The latter are made at Dolbeau on a 134,000 tonne capacity paper machine (No. 5), started up in 1997, and are marketed under the Eminence and Eminence Plus brand names. Their brightness and finish are comparable to mid-range supercalendered papers (SCB) and are designed for the fast-growing advertising flyer, catalogue and magazine markets. Already well-established in uncoated groundwood paper markets Alliance Forest Products Inc. has successfully leveraged this strength to position Eminence and Eminence Plus as leading brands in the soft-nip calendered papers category.

This fall the Donnacona mill will start up a new 152,000 tonne capacity machine which will produce a high-quality SCA paper that will further expand the Company's existing line of supercalendered grades. The new machine (No. 4), representing a net investment of $250 million, is a strategic addition to the Company's assets designed to expand its product line and develop new markets. Machine 4 will have the equipment necessary to meet the needs of the offset market as well as those of the latest generation rotogravure presses. Two machines that currently produce specialty papers will be shut down permanently, and their production will be handled by machines No. 3

Dolbeau and Donnacona

(Production capacities in metric tonnes)

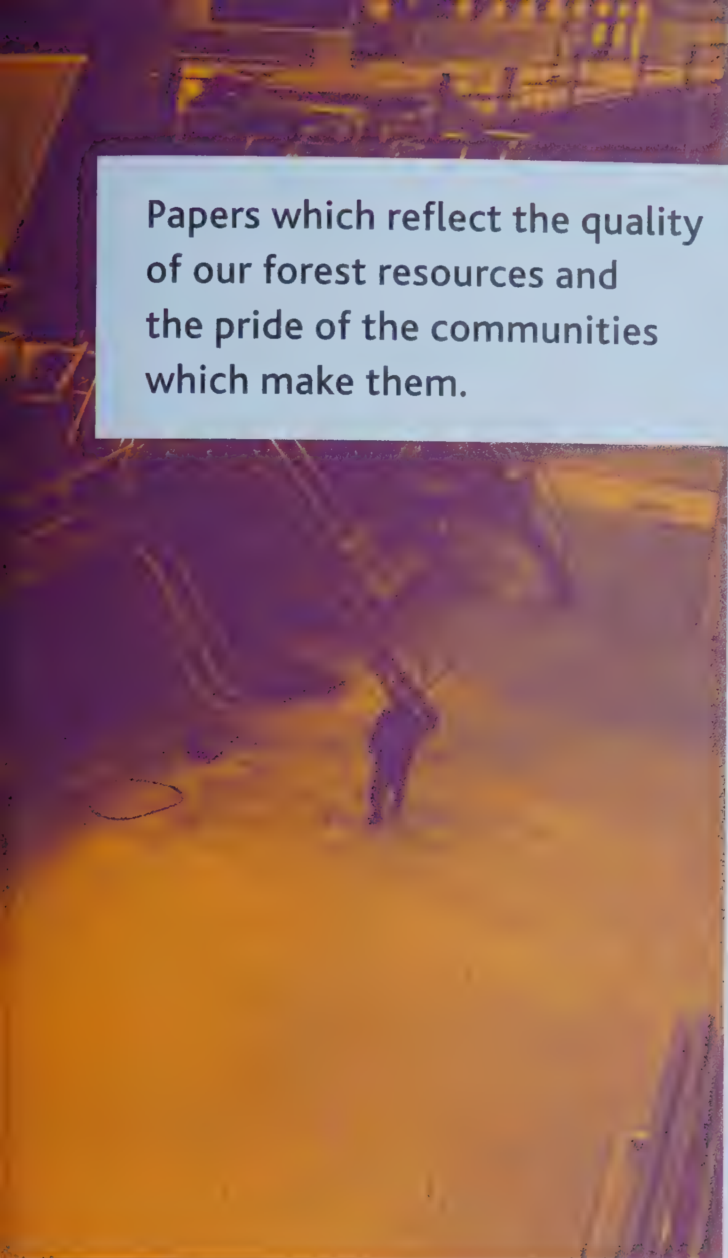
Paper

Dolbeau

Machine	Product	Capacity 2000	Capacity 2001
PM2	Uncoated Groundwood papers	80,000	80,000
PM5	SNC / SNC+	134,000	134,000

Donnacona

Machine	Product	Capacity 2000	Capacity 2001
PM1	Uncoated Groundwood papers	45,000	—
PM2	Uncoated Groundwood papers	45,000	—
PM3	Uncoated Groundwood papers	90,000	90,000
PM4	SC-A / SC-B	—	152,000
Total		**394,000**	**456,000**



Papers which reflect the quality of our forest resources and the pride of the communities which make them.

at Donnacona and No. 2 at Dolbeau. This replacement of equipment and production will complete the product-line conversion begun in 1995. The Donnacona project, although major, will be made easier by leveraging the experience gained at Dolbeau, specifically in the start-up process and in adapting the mill and manpower to produce the new, high quality product.

Once the Donnacona project is operational, the Canadian facilities will have a total of four machines offering a complete line of uncoated groundwood papers to the North American graphic arts industry. The two mills are fully integrated, with modern pulp production facilities and fibre supplied by the Company's own resources allowing for better control of its raw material. The mills will make complementary products that meet customer expectations in terms of printing quality and pressroom runnability.

Sludge, a byproduct of the treatment of a paper mill's effluents, does not always end up at a landfill. Thanks to a waste valorisation program, Alliance Forest Products Inc.'s Donnacona mill delivers thousands of tonnes of sludge to local farmers, to be used as a fertilizer and source of organic matter.

Innovation, optimisation and responsible management

LUMBER AND FORESTRY

Lumber: increased production

Alliance Forest Products Inc. operates 10 sawmills with a combined production capacity that increased to 728 million fbm in 1999 due to continued optimisation efforts and one acquisition. Three of these mills are located in Quebec's northern Lac Saint-Jean region, five in south-eastern Quebec, one in New Brunswick and one in Alabama. The mills also produce wood chips that are the primary raw material used by the paper mills, as well as sawdust and shavings which are sold to containerboard and fibreboard manufacturers. Last July, Alliance Forest Products Inc. acquired all the shares of the Baie-Trinite sawmill in eastern Quebec. The Company is now negotiating with government authorities with a view to doubling the volume of wood it is permitted to harvest under the mill's current timber supply and forest management agreement.

Efforts to improve the Company's sawmill operations continued in 1999, as evidenced by the Dolbeau-Mistassini mill's attainment of ISO 9002 certification last December. This sawmill became the Company's seventh facility to earn this internationally recognised quality-assurance accreditation.

Approximately $20 million will be invested during 2000 in developing the lumber sector. Some $6 million will be invested in the Baker Brook sawmill to increase its efficiency and production capacity, while a major project dealing with curve sawing on one of the Mistassini sawing lines will increase the production at that mill.

Sawmills

Lumber Mills	Location	Capacity (millions fbm)
Mistassini	Québec	175
St-Félicien	Québec	160
Dégelis	Québec	60
Baker Brook	New Brunswick	75
Rivière-Bleue	Québec	30
Lac-des-Aigles	Québec	20
Price	Québec	85
Girardville	Québec	30
Baie-Trinité	Québec	35
Westover	Alabama	58
Total		728

Since 1995, the Company has been using mosaic cutting,a technique that totally protects parcels of forest of as much as 250 hectares. Alternating harvest areas with protected areas limits the effects of fire and erosion damage, in addition to being beneficial for wildlife. Combined with the Company's avant-garde cutting practices, this technique greatly accelerates natural regeneration.

Valued-added related products

The Company's wood-treatment plant at Degelis in Eastern Quebec and I-joist manufacturing plant at Saint-Jacques, New Brunswick, continue to represent the Company's presence in the value-added wood products sector.

In 1999, the Degelis treated wood plant also earned ISO 9002 certification, further underlining the Company's ongoing commitment to providing top-quality products.

The Saint-Jacques, New Brunswick, plant had its best year ever, as production of I-joists, a product which optimises the use of short lumber lengths from the Company's sawmills, surpassed production forecasts by nearly 15%.

Forest management

Under timber supply and forest management contracts granted by the Quebec Natural Resources Department, as well as various commercial agreements, Alliance Forest Products Inc. holds timber-cutting rights to approximately 3 million m^3 of wood, the majority of it in Quebec. The main species harvested is black spruce, one which provides the Company with high-quality fibre for its sawmill operations and for the manufacture of value-added papers. In addition, self-sufficiency in chip supply from its sawmills provides the Company with an advantage over non-integrated producers.

The responsible management of our forests to benefit future generations is a priority for the Company. As required by law, a general forest development plan and more detailed five-year plans are prepared and submitted for government approval, and the Company's harvesting and development plans are assessed and reviewed annually. Alliance Forest Products Inc. uses leading-edge harvesting techniques in an effort to minimise the impact of forestry operations on the soil and landscape thereby ensuring a suitable habitat for wildlife. These techniques are also aimed at encouraging and accelerating natural regeneration by protecting the forest's undergrowth and smaller saplings.

Besides mosaic cutting, which the Company favours despite higher costs, Alliance Forest Products Inc. practices regeneration and soil protection cutting. It encourages the use of multifunctional tree fellers, which are lighter, less cumbersome machines that cause minimal damage to soil and the forest's undergrowth.

A sense of values

SOCIAL REPORT

Management has always encouraged partnership with its employees to ensure effective management of its businesses. The values that drive this process are openness, mutual respect and the desire to create healthy and productive labour relations. An assessment of this approach has highlighted enormous progress made since 1994.

Alliance Forest Products Inc. takes every opportunity to involve its managers, employees and their union representatives in various continuous-improvement initiatives. Several projects have been completed to this end in the areas of training, prevention of workplace accidents, and management of social benefits. The major capital investment projects undertaken by the Company were completed in a spirit of partnership between employees and management. And the same is true of the many initiatives to earn ISO quality-assurance certification.

A role for everyone

Several Company facilities re-examined their structures and organisational methods during the year, aiming to give employees and managers a bigger say in decisions affecting product quality and customer service. The Company consolidated the management of paper sales in an effort to improve synergies between its three manufacturing units and their respective marketing and sales teams. The Coosa Pines administrative structure was also reviewed, which led to the creation of business units serving the needs of three distinct business segments – lumber, market pulp and paper.

Finally, 1999 marked an important milestone in the work organization initiatives underway at the Donnacona mill, with the creation of permanent crews on each of the paper machines. This move is designed to foster complementary skills while increasing efficiency and accountability.

A productive partnership

On the labour relations front, management and the unions remain committed to their desire of ensuring customers a reliable source of supply and unmatched service. The parties demonstrated this commitment in 1999 by signing six-year renewals of the collective agreements in effect at the Dolbeau and Donnacona paper mills, the Mistassini and Girardville sawmills, the Lac Saint-Jean forestry operations and the Goodwater, Alabama, sawmill.

Because of its commitment to providing all employees access to its incentive programs, the Company extended its share purchase plan to Coosa Pines staff, a plan already available to workers at Canadian facilities.

A further result of its partnership with employees is the constant improvement of the Company's occupational health and safety record. The frequency rate of workplace accidents resulting in lost time and the incidence rate (which represents incidents that do not result in absence) declined to 3.23 and 8.14, the best performance in the Company's history.

An unquestionable social contribution

Despite the difficult economic situation in 1999, the Company is endeavouring to keep its donation and sponsorship programs intact. As in past years, the Company gives priority to the health, education, community aid, social and tourism development sectors.

In 1999, members of the senior management team continued to tour the Company's facilities. These visits, aimed at encouraging dialogue with local management teams, employees and their union representatives, and local elected officials and community leaders, provide an opportunity for senior management to convey information on Company initiatives and to improve their understanding of the publics' expectations towards the Company. Also in an effort to get to know managers and employees at Company facilities better, members of the Board of Directors held one annual meeting at a company facility during 1999.

Operating results

Alliance Forest Products Inc. reported net sales of $1,052.7 million for fiscal 1999, compared with $1,085.1 million for 1998 and $823.3 million for 1997. The 3.0% decrease in sales for 1999 versus the previous year was due mainly to low newsprint and pulp prices, a situation that was partly offset by the good performance of the lumber sector and increased shipments for all products. The 31.8% increase in sales in 1998 versus 1997 was attributable to the inclusion of Coosa Pines' operating results for a full year rather than nine months, as was the case in 1997, and also to increased shipments.

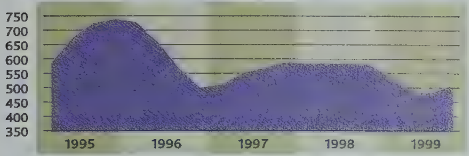
Earnings before interest expenses, taxes, depreciation and amortization (EBITDA) decreased by $82.1 million in 1999, to $100.9 million (9.7% of net sales), compared with $183.0 million (16.9% of net sales) in 1998 and $119.6 million (14.5% of net sales) in 1997. The decreased EBITDA as a percentage of net sales in 1999 is the result of a lower gross margin, which declined to 13.2% last year from 20.3% in 1998. This change is directly linked to lower newsprint and pulp prices during 1999. The improved EBITDA as a percentage of net sales from 1997 to 1998 (to 16.9% from 14.5%) was due to the implementation of the cost-reduction program, as well as of the start-up of the Dolbeau cogeneration plant in December 1997.

Selling, general and administrative expenses were $37.8 million (3.6% of net sales) in 1999, compared with $37.9 million (3.5% of net sales) in 1998 and $25.4 million (3.1% of net sales) in 1997. Higher SG&A expenses in 1998 and 1999 were due to a revamping of the Company's computerised information systems and the implementation of a new sales and distribution structure required for the Company's expanded range of paper products.

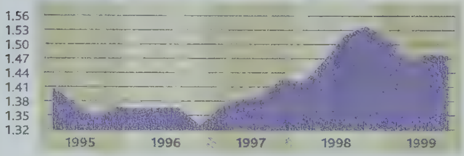
Operating income stood at $9.0 million ($0.25 per common share) in 1999, compared with $94.2 million ($2.46 per common share) in 1998 and $58.8 million ($1.75 per common share) in 1997. Expressed as a percentage of net sales, the Company's operating profit margin decreased to 0.9% in 1999 from 8.7% in 1998. It stood at 7.1% in 1997. In 1999, the improvement of pulp and lumber prices was offset by low newsprint prices. In 1998, the increase in operating profit margin over the previous year was due mainly to productivity gains and cost-control measures. This was partially offset by low prices and higher amortization and depletion charges resulting from the acquisition of the Coosa Pines complex and major modernisation work on the No. 5 paper machine in Dolbeau. Amortization and depletion charges were thus $91.9 million in 1999, $88.8 million in 1998 and $60.8 million in 1997. The $3.1-million increase in 1999 reflects the Company's capital expenditures in the paper sector in 1998 and 1999. As a percentage of net sales, amortization and depletion charges were 8.7% on average in 1999, compared with 8.2% in 1998 and 7.4% in 1997.

The Company registered a net loss of $16.2 million ($0.44 per common share) in 1999, representing a $42.1-million decrease from net earnings of $25.9 million ($0.68 per common share) in 1998; and a $42.7-million decrease from net earnings of $26.5 million ($0.79 per common share) in 1997. Net profit margin was -1.5% in 1999, compared with 2.4% in 1998 and 3.2% in 1997. The decline in financing expenses, to $33.2 million (3.2% of net sales) in 1999 from $58.7 million (5.4% of net sales) in 1998, is due mainly to the June 1998 renegotiation of a US$175 million cross-currency interest rate swap for a period of five years. This, along with the Company's sale of its Enviro-Énergie Alliance Inc. to Boralex Inc., resulted in debt reduction. The increase in financing expenses to $58.7 million in 1998 from $20.6 million in 1997 is mainly attributable to the June 1997 conversion of a portion of the credit facility into the above-mentioned US$175-million cross-currency interest rate swap, and also to financing expenses for the Coosa Pines acquisition which were spread over 12 months, rather than nine months in 1997.

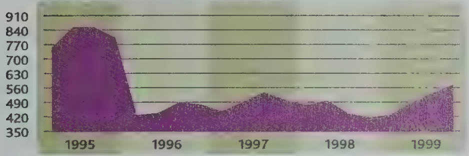
Newsprint prices *(in US$/tonne)*



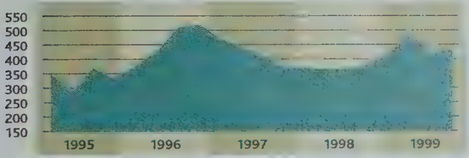
Exchange rate *(CAN$/US$)*



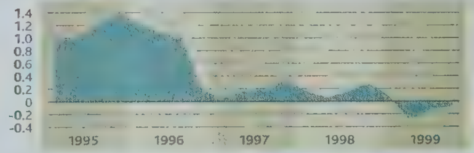
Pulp prices *(in US$/tonne)*



Lumber prices *(in US$/1,000 fbm)*



Quarterly earnings per common share *(in dollars)*



Liquidity and sources of financing

Weaker operating results in 1999, due to low newsprint and pulp prices, particularly in the first half, had a negative impact on cash flow from operating activities, which were $122.8 million ($3.35 per common share) in 1999, compared with $130.1 million ($3.39 per common share) in 1998 and $73.6 million ($2.19 per common share) in 1997. The slight $0.04 difference in per-share cash flow from operating activities in 1999, despite an actual $7.3-million decrease, is a result of the buyback and cancellation, during the year, of 3,045,851 shares. This initiative reduced the average total number of shares outstanding in 1999 to 36.6 million, compared with 38.4 million the previous year.

Changes in non-cash working capital items had a $51.6-million favourable impact on cash flow from operating activities in 1999, due mainly to the combination of improved collection delays in all businesses, reduced inventories and increased accounts payable. Cash flow from operating activities was reduced to $130.1 million in 1998 and $73.6 million in 1997, due to an increase in working capital of $25.0 million in 1998 and $31.3 million in 1997. Also in 1998, the increase in goods in process reduced free cash flows.

At December 31, 1999, working capital was $4.1 million, compared with $135.1 million in 1998 and $73.7 million in 1997. The decrease in 1999 is due mainly to credits linked to capital expenditures. Expressed as a ratio, working capital stood at 1.01:1 in 1999; 1.76:1 in 1998 and 1.37:1 in 1997. Excluding the current portion of long-term debt, working capital was $52.3 million at the end of 1999, compared with $174.8 million in 1998 and $119.5 million in 1997.

For fiscal 1999, cash flow from financing activities required $52.0 million, compared with $8.2 million in 1998. In 1997, financing activities generated $1,001.4 million. In 1999, the Company devoted $89.8 million to debt redemption, and bought back for cancellation 3,045,851 shares, for a total compensation of $50.3 million. This was offset by an increase of $41.4 million in bank indebtedness.

Total long-term debt decreased by $44.2 million in 1999, as a result of the $89.8-million redemption being partly offset by the issuance of $45.6 million in new debt. In 1998, total long-term debt had increased $13.6 million. In 1997, following the Coosa Pines acquisition, long-term debt had increased $460.0 million.

The Company's financial situation remained healthy in 1999, as evidenced by a 35.2% debt ratio at December 31, compared with 36.7% at December 31, 1998, and 34.9% at December 31, 1997.

Following the cancellation of 3,045,851 shares in 1999, shareholders' equity stood at $892.4 million at December 31, 1999, compared with $957.8 million at year-end 1998 and $936.0 million at year-end 1997. In 1998, the Company bought back and cancelled 298,500 shares.

The Company benefits from a $550.8-million credit facility maturing in September 2003 and consisting of four elements: a rotating-term credit facility of $168.0 million, a non-rotating-term credit facility, drawn in U.S. dollars, of $182.8 million, a rotating working capital credit facility of $180.0 million and a swing-line credit facility of $20.0 million. Unused credit facilities stood at $34.0 million at December 31, 1999, and $59.9 million at the end of 1998.

Despite demanding market conditions in 1999, Alliance Forest Products Inc. had the financial resources to pay its debts and fund its working capital and capital expenditures.

On February 10, 2000, the Company sold its Alabama timberlands for a total consideration of US$302.9 million (approximately CAN$440.0 million). The same day, it announced its intention to buy back and cancel up to $100 million of its shares, at a price to be determined, between $18 and $21 per share.

Divestiture

On January 28, 1999, the Company sold all of its shares in Enviro-Énergie Alliance Inc. (its Dolbeau cogeneration plant) for a total consideration of $76.0 million, corresponding to book value. Of this amount, $60.0 million was paid in cash to the Company and the remaining $16.0 million was paid with preferred shares, redeemable by the issuer before year-end 2002, and paying a 4% annual dividend.

Investments

In its determination to increase shareholder value, the Company has adopted guidelines and criteria to evaluate its investment projects. Among the main ones are requirements regarding debt ratio and return on investment. Management is taking a cautious approach to debt so that the Company will not be unduly sensitive to interest-rate fluctuations.

Capital expenditures were $120.6 million in 1999, compared with $114.4 million in 1998 and $214.1 million in 1997. For the last fiscal year, the main project investment in Canada was construction of the No. 4 paper machine at Donnacona, which is scheduled to begin operating in September 2000. This $275-million project (representing a discounted actual cost of $250 million for the Company) was announced in June 1998 and is a vital part of the Company's strategic plan to focus on value-added papers. Other major investments were at Coosa Pines which related to expenditures necessary to comply with the Cluster Rules. Capital expenditures in 1997 were higher, resulting from investments at Dolbeau, where the Company rebuilt paper machine No. 5 and built a cogeneration plant.

During 1999, the Company re-examined its business objectives and the various means to maintain the profitability and competitiveness of its Coosa Pines complex. As a result, Alliance Forest Products Inc. has developed a US$170-million strategic plan to be implemented between 2000 and 2002.

Taking into account the evolution of cash flow, its current credit facility and the sale of its timberlands, the Company is confident it will have the necessary resources to pay for its capital expenditures, which should reach $275 million in 2000.

Since its 1997 acquisition of Coosa Pines, approximately 56% of the Company's total assets are in the United States. Almost all of these non-monetary elements, accounted for at cost, were converted into Canadian currency at the exchange rate in effect at the time of the transaction (CAN$1.37/US$1.00).

At December 31, 1999, goodwill, at amortised cost, stood at $41.5 million, or 2.4% of total assets, compared with 2.3% in 1998 and 2.5% in 1997.

Paper sector

At December 31, 1999, Alliance Forest Products Inc. operated three paper mills – at Donnacona and Dolbeau, Quebec, and the Coosa Pines mill at Childersburg, Alabama. Together, these mills have eight operating paper machines, with a combined capacity of 787,000 tonnes annually, producing newsprint and uncoated groundwood papers. The latter are used primarily for printing advertising inserts, magazines, catalogues and books.

As in previous years, the paper sector in Fiscal 1999 represented the bulk of the Company sales. Paper accounted for 50.0% of the Company's total sales during the year, down from 56.3% in 1998 and 53.6% in 1997.

Paper sales for 1999 were $526.4 million, versus $611.2 million in 1998 and $441.2 million in 1997. The 13.9% decline in net paper sales from 1998 to 1999, despite larger shipments and increased production of value-added papers, was mainly the result of weak newsprint prices during the first nine months of the year. In fact, the resumption of strikebound operations at a major newsprint producer late in fiscal 1998 upset the supply-demand balance, which in turn negatively impacted prices. During this period, despite sustained demand in North America, producers' inventories grew by approximately 50%, reaching 600,000 tonnes by spring. The 38.5% increase in paper sales from 1997 to 1998 was the result of a recovery in average paper prices, increased shipments, the addition of higher-margin Eminence and Eminence Plus soft-nip calendered papers to the Company's product line, and the consolidation over 12 months, rather than nine, of the operating results of the Coosa Pines paper manufacturing facilities.

The paper sector suffered an operating deficit of $32.6 million, down $99.6 million from operating income of $67.0 million for 1998, and $55.4 million less than the positive $22.8 million figure for 1997. Thus, the operating profit margin declined in 1999 to -6.2%, compared with +11.0% in 1998 and +5.2% in 1997. The weakening of the operating profit margin in 1999 reflects declining paper prices during the first half of the year.

At December 31, 1999, total paper sector assets stood at $1,037.5 million, compared with $1,035.8 million at the same date in 1998 and $1,020.0 million at the end of 1997.

Capital expenditures reached $84.3 million in 1999, compared with $65.6 million in 1998 and $187.6 million in 1997. The higher amounts in 1997 and 1999 reflect, on the one hand, the major expenditures at the Dolbeau mill in 1996 and 1997 for construction of a cogeneration plant and conversion of the No. 5 paper machine to manufacture high-quality soft-nip calendered papers and, on the other hand, the start of the construction on the No. 4 paper machine at Donnacona in 1999.

Last spring, the Company announced a strategic plan that included capital investments in paper production for Coosa Pines. The major element of this program consists in the construction of a new de-inking plant that will increase the recycled-pulp content of the Company's newsprint from the current 40% to 100%. In addition, increasing the speed and efficiency of the paper machines will boost their combined annual capacity to 448,000 tonnes from 393,000 tonnes. Investments of approximately US$170 million, beginning this year and extending over the next three, will be made to complete this project.

Pulp sector

Besides the pulp produced for its own needs, the Coosa Pines complex produced nearly 260,000 tonnes of kraft pulp in 1999, composed of some 238,000 tonnes of fluff pulp used in the manufacturing of specialised consumer products, and 24,000 tonnes of Southern Bleached Hardwood Kraft (SBHK) pulp. The majority of this production was sold to Kimberly-Clark Corporation under renewable long-term supply contracts negotiated at the time of the mill acquisition in 1997.

Pulp sales reached $182.1 million in 1999, or approximately 17.3% of total sales, compared with $176.0 million in 1998, or 16.2% of total sales, and $122.8 million in 1997, or 14.9% of total sales. The decline in pulp prices that began in the second quarter of 1998 continued early into the corresponding quarter of 1999. A return to more balanced market conditions resulted in higher prices late in fiscal 1999. The $53.2 million increase in pulp sales in 1998 was mainly the result of the consolidation of the Coosa Pines results for a full year, rather than nine months in 1997.

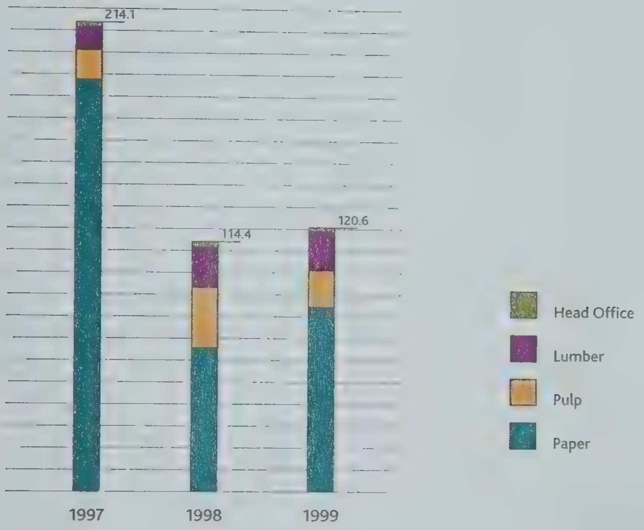
Despite the gradual improvement of market conditions in 1999, this segment generated an operating deficit of $5.8 million, an $11.1 million improvement over the loss of $16.9 million in 1998, and a slight deterioration compared with the $4.5-million operating deficit of 1997.

Capital expenditures reached approximately $17.1 million in 1999, compared with $27.8 million in 1998 and $13.7 million in 1997. Total pulp-sector assets decreased by about 8.3% during the year, settling at $389.1 million at December 31, 1999, compared with $424.2 million at the same date in 1998 and $376.1 million at December 31, 1997.

The Company's US$ 170 million strategic plan will include modifications to the production of SBHK pulp and an increase in softwood market pulp production of approximately 29,000 tonnes, currently used in the manufacture of newsprint.

Capital expenditures

(in millions of dollars)



Lumber and forestry sectors

The Company operates 10 sawmills that produce lumber, used mainly in the construction sector; wood chips, the primary raw material used in the paper mills; as well as sawdust and shavings, which are sold to containerboard and fibreboard manufacturers. The mills also produce bark that the Company uses for fuel. Three mills are located in the Lac-St-Jean region of Quebec, five in south-eastern Quebec, one in northern New Brunswick and one in Alabama.

The Company is also active in value-added wood products which provide better margins and are not subject to export quotas imposed by the United States. The Company has a wood-treatment plant in south-eastern Quebec and an I-joist plant at St-Jacques, New Brunswick.

As in fiscal 1998, the lumber sector in 1999 was the Company's best performer, due mainly to continued strong housing starts in North America.

The strength of the lumber sector continued into 1999, as the Company's operations reached a new sales record of $344.2 million, a $46.3 million improvement over sales of $297.9 million in 1998 and $84.9 million more than the 1997 figure of $259.3 million. As a percentage of total sales, lumber sales represented 32.7% in 1999, compared with 27.5% in 1998 and 31.5% in 1997.

The more than 15.5% increase in lumber sales in 1999 was partly the result of higher average prices and increased shipments. In fact, helped by the strength of the North American economy and its favourable impact on the number of housing starts, prices obtained by the Company for its eight-foot studs, as well as those for its random lengths, were on average 10% higher than the previous year. As for its value-added lumber-related products, the market for I-joists, used in many different kinds of construction, was particularly profitable for the Company in 1999. Business was, however, more competitive in the treated wood segment. The 14.9% increase in lumber sales from 1997 to 1998 was mainly the result of the consolidation with the Coosa Pines sawmill for a full year, rather than nine months in 1997.

As with net sales, operating income for the lumber sector rose in 1999, reaching $47.4 million, compared with $44.1 million in 1998 and $40.5 million in 1997. For the most part, average prices for the Company's lumber products climbed to levels comparable to those of 1997, which were 5% to 10% above prices obtained in 1998. The strength of the North American housing market and the recovery of the Japanese market were the main reasons for the improvement in the lumber market in 1999.

Despite the price recovery, the operating profit margin declined to 13.8% of net sales in 1999, compared with 14.8% in 1998 and 15.6% in 1997. Increased stumpage fees were the main reason for the shrinking operating profit margin. In 1998 the decline was principally the result of the gradual decline in prices.

Although capital expenditures remained relatively stable in 1999, at $18.4 million, compared with $17.9 million in 1998 and $10.1 million in 1997, total lumber-sector assets stood at $263.4 million at December 31, 1999, against $248.6 million at December 31, 1998, and $250.4 million at the same date in 1997. This increase of nearly 6.0% from 1998 to 1999 is mainly the result of the Company's decision to acquire, in July 1999, all the shares of the Baie-Trinité sawmill, in which it had held a 25% minority interest since 1997. This acquisition was accounted for according to the purchase method.

The Company plans to invest some $20 million in its sawmills in 2000 in order to increase their productivity through increased product diversification and reduced production costs. This money will be used, among other things, to purchase equipment and build logging roads.

Risks and uncertainties

Price fluctuations

The Company operates in cyclical markets where competition is robust and intense and where variations in supply and demand can cause price fluctuations. The main factors affecting supply are the construction of new mills and increases in the production capacities of existing mills. In the paper sector, the economic situation and prices are the main factors impacting demand. In general, lumber prices fluctuate because of the economic situation, the seasonal nature of the construction industry, as well as its sensitivity to interest rates and weather.

A variation of US$10 a tonne in the price of paper would result in a difference of about $12.0 million in the Company's operating income. A variation of US$10 a tonne in the price of pulp would result in a difference of about $4.0 million in operating income. A variation of US$10 a tonne in the price of 1,000 fbm of lumber would result in a difference of about $9.0 million in operating income.

Foreign exchange and interest rates

A significant portion of the Company's net sales and debt are denominated in U.S. currency and are therefore influenced by fluctuations in exchange rates between the Canadian and U.S. dollars. In addition, because a large portion of the Company's debt consists of variable-rate loans, fluctuations in interest rates can considerably influence the cost of the Company's capital. In order to facilitate effective management of the volatility resulting from these uncertainties, thereby limiting the financial risks the Company faces in the normal course of its operations, the Board of Directors has adopted a policy that allows the Company to use various derivative financial instruments, such as options, currency futures and cross-currency interest rate swaps. Thus, the Company has in place a hedging program using option contracts (collar and option) that currently cover 50% of receipts in U.S. dollars for the next 36 months.

Because of this hedging program, the fact that a significant portion of the Company's operating costs are now incurred in the United States in U.S. currency, and the fact that the major portion of its long-term debt is in U.S. dollars, the Company's exposure to risks associated with exchange-rate fluctuations is negligible.

Native claims

Quebec's First Nations Cree Indians are contesting the approval procedure for submitting forest development plans and obtaining the permits necessary to harvest wood on all lands covered by the James Bay and Northern Quebec Agreement. More specifically, they are demanding that the processes for assessing and reviewing the environmental and social impacts be implemented in compliance with their interpretation of the Agreement. To this end, they filed an action in July 1998, seeking an injunction to halt forest development until such time as the federal and provincial governments, and consequently the forest companies, submit their harvest planning to what the Cree insist is the proper process. In the opinion of management, the Cree claims, which may eventually result in the exchange of money between the native peoples and the different levels of government, should have no significant impact on either the Company's operations or financial situation.

Timber-cutting rights

The wood-supply system in Canada is somewhat different to that of the United States. In Canada, as a general rule, companies harvest timber on public lands and pay the government proportional stumpage fees, while in the U.S. forest companies harvest most of their timber on private land.

In 1999, the Quebec Government increased the stumpage fees paid by companies that develop forest resources, while in New Brunswick, licence fees remained stable. For the Company, these increases have resulted in a 9.8% increase of its stumpage fee expenses. Management, either directly or through associations in which it is a member, is requesting that the Quebec Government stop increasing these stumpage fees, a move that the Company feels is untimely and threatens the profitability of its sawmills. At the same time, the Company is continuing its efforts to control other production costs in order to offset the adverse effects of the stumpage fee increases.

In 1999, the Company's Coosa Pines complex obtained approximately 30% of its needs from its own private woodlands, the balance through open market purchases of timber or chips.

Canadian lumber quotas

Canada and the United States reached an agreement in 1996 on lumber export quotas. Under this agreement, which extends through 2001, Canada agreed to restrict its annual lumber exports to the U.S. to approximately 14.7 billion fbm. Quantities in excess of this limit are subject to an export tax of $50 per 1,000 fbm for the first 650 million fbm and $100 per 1,000 fbm for any additional amounts. For calculation purposes, the period covered by this agreement begins April 1 and ends March 31 each year.

This agreement expires in 2001 and the Company opposes is renewal. The Company believes that its restrictions amount to trade barriers that are detrimental to the development of Canadian forest products companies. This is why, in cooperation with other industry members, management intends to continue its representations through the organisations concerned in order to prevent the renewal of this agreement.

At the same time, the Company continues to actively develop various strategies aimed at reducing the negative impact of these quotas, among other things the development of tax-exempt products. In addition, two of its 10 sawmills – at Baker Brook, New Brunswick, and Westover, Alabama – are totally exempt from quotas.

Environment

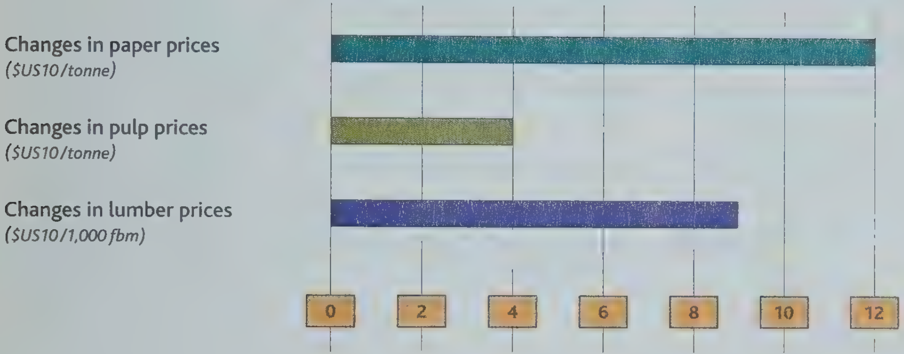
In the sectors in which it operates, Alliance Forest Products Inc. is subject to increasingly stringent environmental laws, standards and regulations dealing with water and air quality. In both Canada and the United States, the laws are applied by the different levels of government. Not only does Alliance Forest Products Inc. have no choice but to adapt to new regulations, but it takes pride in the fact that it has on some occasions acted proactively, rather than reactively.

In Canada, the Company manufactures its paper primarily from wood chips produced by its sawmills, while in the U.S. the Company produces enough of its own de-inked recycled pulp to meet 40% of its newsprint production.

In 1998, U.S. authorities enacted new regulations, grouped under the so-called Cluster Rules, that have tightened standards applicable to forest industry effluent and atmospheric emissions. In order to adapt its Coosa Pines mill to comply with these new rules, the Company invested about $40 million in 1999 to build a brownstock washing facility that will optimise the recovery of black liquor. The Company estimates that it will have to invest an additional $45 million by January 2001 in order to, among other things, install equipment to recover and incinerate methanol-rich atmospheric emissions.

Impact on operating income

(in millions of dollars)



Year 2000 date change

During fiscal 1999, Alliance Forest Products Inc. successfully completed the corrective and certification measures necessary to ensure a smooth transition of its management information and process-control systems to the year 2000.

As fiscal 1999 came to a close, the Company confirmed that all its management information and process-control systems would successfully make the date-change transition. The same was true for the integrated software package that managed the finance, procurement, human resources, payroll and maintenance services, and which the Company purchased in 1998 to increase the effectiveness of its backup information systems.

During the year 2000 date change, the task force responsible for supervision and certification of all the information systems remained in permanent contact with the Company's major suppliers to ensure availability of the necessary supplies and services for its operation. There was no interruption of supplies either before or after December 31, 1999, and, according to the most recent information obtained from strategically important suppliers, none is expected. Thus, there were no disruptions of the Company's operations, and none are expected.

The 2000 date change also had no impact on the Company's compliance with environmental laws, standards and regulations currently in force. Based on the latest data, the Company has maintained constant and effective control of effluent and atmospheric emission.

The year 2000 transition required no material expense by the Company, in light of its young age, its use of leading-edge technologies, precautions taken in the past, and the fact that the necessary changes were implemented within more comprehensive programs. Thus, the Company spent approximately $800,000 to adapt all of its information systems for the date change.

With the year 2000 challenge successfully met, Alliance Forest Products Inc. is able to continue operations and adequately meet the needs of its customers.

Outlook

Despite some fears about the continuance of expansionist monetary policies by North American and European governments, fiscal 2000 is shaping up to be a more profitable year for the Company. Although the expected short-term rise in interest rates may lead to some slowdown in the growth rates of these economies, the increase in average North American household income will help maintain consumer confidence. This in turn should continue to have a positive influence on housing starts and advertising expenditures. In addition, the strength of Asian economies should also help to sustain demand for the majority of forest products. Thus, the favourable outlook encouraged by these conditions should spur the continued improvement of the Company's results over the coming quarters.

Newsprint prices should continue the gradual recovery that began in the closing quarter of 1999. Over the longer term, the fact that no new increases in capacity are anticipated in North America should help maintain price stability. For its part, demand for supercalendered papers, which has been growing steadily over the past several years, should remain relatively strong, as magazines and inserts benefit from increased advertising expenditures.

The continuation of relatively low interest rates in both Canada and the United States should encourage housing starts and, as a consequence, demand for lumber. In this way, producers will be more easily able to maintain their inventories at reasonable levels without having to resort to reducing prices. Economic recovery in Asia, with its beneficial impacts on demand, should also persist in 2000, contributing to an upswing in exports and the stability of lumber prices.

Regards pulp products, the global absorbent products market, for which fluff pulp is a major raw material, should see continued strength into the next fiscal year. The world market for all grades of pulp will continue to see good growth, which, combined with the past year's production curtailments and capacity shutdowns, should lead to a continued increase in prices. The Company will benefit from these favourable conditions in terms of both production volume and prices.

The anticipated recovery of prices for most forest products in 2000 will help intensify the pace of growth of the Company's net sales, as well as improve its ability to increase the return on its operations.

Management's responsibility

The consolidated financial statements of Alliance Forest Products Inc. and the other financial information included in this annual report are the responsibility of the Company's management and have been examined and approved by its Board of Directors. These consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles and include some amounts that are based on management's best estimates using careful judgment. The selection of accounting principles and methods is management's responsibility.

The Company maintains internal control systems designed to ensure that financial information is relevant and accurate and that assets are safeguarded. An internal audit program was implemented in order to evaluate the systems.

Management recognizes its responsibility for conducting the Company's affairs to comply with the requirements of applicable laws and established financial standards and principles, and for maintaining proper standards of conduct in its activities. The Board of Directors supervises the financial statements and other financial information through its audit committee, which is comprised solely of outside directors.

This committee's role is to examine the financial statements and recommend that the Board of Directors approve them, to examine the internal control and information protection systems and all other matters relating to the Company's accounting and finances. In order to do so, the audit committee meets periodically with the internal and external auditors, either with or without the Company's management, to review their respective audit plans and discuss the results of their examinations. In addition, the committee reviews the internal audit reports. This committee is responsible for recommending the appointment of the external auditors or the renewal of their engagement.

The Company's external auditors, Raymond Chabot Grant Thornton General Partnership, have audited the Company's financial statements and their report indicating the scope of their audit and their opinion of the financial statements is presented below.

Pierre Monahan
President and Chief Executive Officer

Daniel Tardif, CA
Senior Vice President and
Chief Financial Officer

Montreal, February 15, 2000

Auditor's Report

To the Shareholders of Alliance Forest Products Inc.

We have audited the consolidated balance sheets of Alliance Forest Products Inc. as at December 31, 1999 and 1998 and the consolidated statements of earnings, retained earnings, contributed surplus and cash flows for each of the years in the three-year period ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1999 and 1998 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1999 in accordance with generally accepted accounting principles in Canada.

Raymond Chabot Grant Thornton

Montreal, Canada
February 15, 2000
Chartered Accountants

Consolidated statements of earnings

Years ended December 31,
(In millions of Canadian dollars, except net earnings per share)

	1999	1998	1997
Sales	$1,052.7	$1,085.1	$823.3
Operating costs and expenses			
Cost of goods sold	914.0	864.2	678.3
Selling, general and administrative expenses	37.8	37.9	25.4
Depreciation, amortization and depletion	91.9	88.8	60.8
	1,043.7	990.9	764.5
Operating income	9.0	94.2	58.8
Net financing expenses	33.2	58.7	20.6
Earnings (loss) before income taxes	(24.2)	35.5	38.2
Income taxes (Note 5)			
– Current (recovery)	(0.5)	(2.6)	2.9
– Deferred	(7.5)	12.2	8.8
	(8.0)	9.6	11.7
Net earnings (loss)	(16.2)	25.9	26.5
Net earnings (loss) per common share	$(0.44)	$0.68	$0.79

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated statements of retained earnings and contributed surplus

Years ended December 31,
(In millions of Canadian dollars)

	1999	1998	1997
Retained earnings			
Balance, beginning of year	$188.2	$162.3	$154.8
Net earnings (loss)	(16.2)	25.9	26.5
Share issuance expenses less deferred income taxes of $8.9	—	—	(19.0)
Balance, end of year	$172.0	$188.2	$162.3
Contributed surplus			
Balance, beginning of year	$1.3	$—	$—
Share redemption premium	11.0	1.3	—
Balance, end of year	$12.3	$1.3	$—

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated statements of cash flows

Years ended December 31,
(In millions of Canadian dollars)

	1999	1998	1997
Operating activities			
Net earnings (loss)	$(16.2)	$25.9	$26.5
Non-cash items			
Depreciation, amortization and depletion	91.9	88.8	60.8
Amortization of foreign exchange loss	3.9	16.9	—
Pension expense	(0.9)	11.3	8.8
Deferred income taxes	(7.5)	12.2	8.8
Changes in working capital items (Note 6)	51.6	(25.0)	(31.3)
Cash flows from operating activities	122.8	130.1	73.6
Investing activities			
Acquisition of commercial activities	—	—	(837.8)
Disposal of a subsidiary (Note 4)	60.0	—	—
Acquisition of fixed assets	(120.6)	(114.4)	(214.1)
Increase in other assets	(4.4)	(7.5)	(23.1)
Cash flows from investing activities	(65.0)	(121.9)	(1,075.0)
Financing activities			
Increase (decrease) in bank indebtedness	41.4	(17.7)	(6.4)
Issue of long-term debt	45.6	58.8	566.9
Repayment of long-term debt	(89.8)	(45.2)	(109.1)
Issue of common shares	1.1	0.6	550.0
Redemption of common shares	(50.3)	(4.7)	—
Cash flows from financing activities	(52.0)	(8.2)	1,001.4
Net increase in cash and cash equivalents and cash and cash equivalents, end of year	$5.8	$—	$—

Cash and cash equivalents at the end represent a short-term investment.

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated balance sheets

As at December 31,
(In millions of Canadian dollars)

	1999	1998
Assets		
Current assets		
Short-term investment, 4.5%, maturing in January 2000	$5.8	$—
Accounts receivable, net of allowance for doubtful accounts of $1.4 ($1.9 in 1998)	132.9	154.3
Income taxes receivable	11.9	5.0
Inventories (Note 7)	136.1	145.8
Prepaid expenses	9.3	7.3
	296.0	312.4
Property, timberlands, plant and equipment (Note 8)	1,367.1	1,369.7
Other assets (Note 9)	71.3	89.7
	1,734.4	1,771.8
Liabilities		
Current liabilities		
Bank indebtedness (Note 10)	52.9	11.5
Trade and other accounts payable (Note 11)	190.8	126.1
Current portion of long-term debt	48.2	39.7
	291.9	177.3
Long-term debt (Note 12)	436.6	516.7
Pension liability and postretirement benefits obligation (Note 13)	71.7	72.6
Deferred income taxes (Note 5)	41.8	47.4
	842.0	814.0
Shareholders' equity		
Capital stock (Note 14)	708.1	768.3
Contributed surplus (Note 14)	12.3	1.3
Retained earnings	172.0	188.2
	892.4	957.8
	$1,734.4	$1,771.8

The accompanying notes are an integral part of the consolidated financial statements.

On behalf of the Board,

Robert Després

Gaston Blackburn

As at December 31,
(In millions of Canadian dollars, unless otherwise indicated)

1. Governing statutes and nature of operations

The Company was incorporated on March 11, 1994 under the Canada Business Corporations Act. Alliance Forest Products Inc. is an integrated company which harvests timber, manages forest land and produces and sells pulp, newsprint, uncoated groundwood paper, lumber and related products.

2. Change in accounting policy

In 1999, the Company retroactively adopted the recommendations of the Canadian Institute of Chartered Accountants with respect to the presentation of the cash flow statement. Under the new recommendations, cash and cash equivalent are redefined. As a result of applying these new recommendations, changes in bank indebtedness are presented with financing activities. Previously, bank indebtedness was included with cash resources.

3. Accounting policies

The consolidated financial statements are expressed in Canadian dollars and were prepared in accordance with generally accepted accounting principles in Canada, which can differ from the generally accepted accounting principles used in the United States, as shown in Note 21.

Accounting estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in Canada requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the year. Actual results could differ from management's estimates.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and all of its subsidiaries, which are wholly owned.

Foreign currency translation

Monetary assets and liabilities in foreign currency of the Canadian companies and the integrated foreign subsidiaries are translated into Canadian dollars at exchange rates in effect at the balance sheet date, whereas non-monetary assets and liabilities are translated at the exchange rates in effect at transaction dates. Revenues and expenses in foreign currency are translated at the average rate in effect during the year with the exception of depreciation, which is translated at the historical rate. Gains and losses resulting from the translation of foreign currency transactions are included in earnings. Moreover, unrealized exchange gains and losses relating to monetary items with a remaining life extending beyond one year after the balance sheet date are deferred and amortized over the remaining life of these monetary items.

Derivative financial instruments

The Company, whose head office is in Montreal, operates internationally. Its principal customers are located in Canada and the United States.

The Company is exposed to substantial market risks as a result of foreign exchange rate fluctuations. To reduce these risks, it uses derivative financial instruments such as options (put options and collars), foreign forward exchange contracts and cross-currency interest rate swaps. It does not hold or issue any derivative financial instruments for commercial or speculative purposes. The derivative financial instruments are subject to the standard credit terms and conditions, financial controls and management and risk monitoring procedures. In management's opinion, none of the parties to the existing derivative financial instruments are expected to default on their obligations given that they are financial institutions with a high credit rating.

Unrealized gains and losses on foreign currency options designated to hedge the Company's future income are recognized when the options are exercised, that is, on the transaction dates. Unrealized gains and losses on forward foreign exchange contracts designated to hedge equipment purchases are recognized when the contracts expire. Hedged sales in foreign currencies are recorded in accordance with the terms of the hedge. Option premiums are amortized over the option term.

As at December 31,
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3. Accounting policies (continued)

Payments and receipts under cross-currency interest rate swaps are recorded as an adjustment of financing expenses. Unrealized gains and losses resulting from the translation of these instruments are deferred and amortized over the remaining term of the contract.

Cash and cash equivalents

The Company's policy is to present cash and temporary investments having a term of three months or less with cash and cash equivalents.

Inventory valuation

Inventories of raw materials and of operating and maintenance supplies are valued at the lower of average cost and replacement cost. Goods in process and finished goods are valued at the lower of average cost and net realizable value and include the cost of raw materials, direct labour and manufacturing overhead.

Property, timberlands, plant and equipment

Property, timberlands, plant and equipment are stated at cost net of government grants. Fixed assets are depreciated on a straight-line basis using rates based on the estimated useful lives of the assets as follows:

Timberlands	Based on volumes of wood cut
Buildings	Up to 40 years
Machinery and equipment	Up to 20 years

Capitalized interest on property under construction is calculated at the end of each accounting period by applying the interest rate on the long-term debt financing these projects to the average cost of the assets in process.

Goodwill

Goodwill is amortized on a straight-line basis over 30 years. It is valued periodically, which consists in examining generated cash flows and the return on activities acquired as compared to the forecasts prepared upon acquisition. Any permanent reduction in the amortized value of goodwill is written off and charged to earnings.

Long-term financing expenses

Financing expenses on long-term debt are amortized under the straight-line method over the term of the related debt.

Long-term investments

Long-term investments are accounted for at cost. Where there is a permanent loss in value of a long-term investment, the amount recorded on the statement of earnings is written-down to recognize this loss in value.

Pension plans and other postretirement benefits

Pension expenses are determined based on actuarial valuations. The pension expense comprises the cost of retirement benefits accruing to employees for services rendered during the period. The difference between employer contributions and amounts stated as pension expense is recorded under pension obligation.

The Company also offers life and health insurance coverage to certain employees when they retire. For the Canadian plans, the cost of these benefits is charged to earnings as amounts are paid. For the American plans, these costs are charged to earnings as services are rendered by the employees.

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4. Disposal of a subsidiary

On January 28, 1999, the Company disposed of all of the shares of Enviro-Énergie Alliance inc. for an amount equal to their carrying amount, i.e. $76.0, of which $60.0 was cash and $16.0 was preferred shares with a cumulative dividend of 4% and redeemable at the issuer's option until 2002.

The assets and liabilities of the subsidiary disposed of are detailed as follows:

Accounts receivable	$1.1
Inventories	0.3
Prepaid expenses	0.2
Land, buildings, machinery and equipment	73.1
Deferred income taxes	1.9
Other assets	0.6
Accounts payable and accrued liabilities	(0.9)
Other liabilities	(0.3)
	$76.0

5. Income taxes

The Company's effective income tax rate is calculated as follows:

	1999	1998	1997
Combined basic Canadian rate	36.9%	36.9%	36.9%
Increase (decrease) in the tax rate for the following			
– Federal surtax and large corporations tax	(4.8)%	4.1 %	3.4%
– Tax credit for manufacturing and processing profits	(1.4)%	(3.0)%	(4.4)%
– Amortization of the difference between the tax cost and the book value of the fixed assets acquired on May 12, 1994	6.2%	(6.3)%	(7.6)%
– Income from American subsidiaries that are subject to different tax rates	(2.4)%	0.2 %	0.4%
– Difference in tax rate on losses on the disposal of assets and foreign currency contracts	(0.4)%	(3.6)%	—
– Other	(1.0)%	(1.3)%	1.9%
Effective tax rate	33.1%	27.0%	30.6%

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5. Income taxes (continued)

The components of the Company's net deferred income tax liability are as follows:

	1999	1998
Long-term deferred income taxes		
Tax depreciation in excess of book depreciation	$83.5	$68.8
Pension cost	(3.5)	(3.2)
Share issuance expenses	(3.1)	(5.0)
Provisions deductible in subsequent years	(31.8)	(11.4)
Other	(3.3)	(1.8)
	$41.8	$47.4

Cash payments for income taxes in 1999 amounted to $6.6 ($11.5 in 1998 and $8.2 in 1997).

6. Changes in working capital items

	1999	1998	1997
Accounts receivable	$28.6	$(26.9)	$(73.1)
Income taxes receivable	(6.9)	0.1	3.5
Inventories	9.4	(11.9)	(3.8)
Prepaid expenses	(2.2)	0.5	(4.1)
Accounts payable and accrued liabilities	22.7	13.2	46.2
	$51.6	$(25.0)	$(31.3)

7. Inventories

	1999	1998
Raw materials		
Logs	$48.8	$46.5
Chips and other	7.2	4.3
Operating and maintenance supplies	36.7	36.1
Goods in process	13.2	23.3
Finished goods	30.2	35.6
	$136.1	$145.8

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(In millions of Canadian dollars, unless otherwise indicated)

8. Property, timberlands, plant and equipment

	1999		
	Cost	Accumulated depreciation	Net
Land	$6.0	$—	$6.0
Timberlands	286.7	40.7	246.0
Buildings	122.8	28.3	94.5
Machinery and equipment	1,104.3	234.2	870.1
Property under construction	150.5	—	150.5
	$1,670.3	$303.2	$1,367.1

	1998		
	Cost	Accumulated depreciation	Net
Land	$5.5	$—	$5.5
Timberlands	282.9	28.9	254.0
Buildings	126.9	17.7	109.2
Machinery and equipment	1,126.2	175.0	951.2
Property under construction	49.8	—	49.8
	$1,591.3	$221.6	$1,369.7

During the year, the Company capitalized $4.1 of interest ($0 in 1998 and $7.6 in 1997) to the cost of property under construction.

9. Other assets

	1999	1998
Goodwill, at amortized cost	$41.5	$41.0
Foreign exchange loss (gain), at amortized cost	(3.1)	30.8
Long-term financing costs, at amortized cost	7.5	9.4
Preferred share investment (Note 4)	16.0	—
Other	9.4	8.5
	$71.3	$89.7

10. Bank indebtedness

As at December 31, 1999, the bank indebtedness comprises a short-term loan of $47.0 bearing interest at a rate based on banker's acceptances plus 2.5% (7.78%) and outstanding cheques. In 1998, bank indebtedness comprises solely cheques issued and outstanding.

The bank indebtedness is secured by a movable and immovable hypothec on the universality of the property of the Company and its subsidiaries.

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(In millions of Canadian dollars, unless otherwise indicated)

11. Trade and other accounts payable

	1999	1998
Accrued and trade accounts payable	$114.0	$92.8
Accounts payable relating to fixed assets	44.1	0.9
Salaries and vacation payable	24.4	25.3
Taxes and stumpage dues	8.3	7.1
	$190.8	$126.1

12. Long-term debt

	1999	1998
Credit facility at variable rates ranging from 6.50% to 7.75%	$471.7	$549.7
Other loans, rates ranging from 8.00% to 12.125%, maturing at various dates until 2008	13.1	6.7
	484.8	556.4
Current portion of long-term debt	48.2	39.7
	$436.6	$516.7

Credit Facility

The credit facility, which amounts to $550.8 (or the U.S. dollar equivalent), matures in September 2003, comprises four components: a rotating term credit facility of $168.0 (or the U.S. dollar equivalent), a non-rotating term credit facility of $182.8 drawn in U.S. dollars, a rotating working capital credit facility of $180.0 (or the U.S. dollar equivalent) and a swing line credit facility of $20.0 (or the U.S. dollar equivalent).

The facility bears interest at rates based on banker's acceptances plus 0.5% to 1.5% or the prime rate plus 0% to 0.5% for amounts drawn in Canadian dollars and on LIBOR plus 0.5% to 1.5% or on the U.S. prime rate plus 0% to 0.5% for amounts drawn in U.S. dollars. The premiums are determined in accordance with the Company's financial leverage ratio, on a quarterly basis.

This credit facility is payable in quarterly instalments of varying amounts. It is secured by a movable and an immovable hypothec on the universality of the Company's property and that of its subsidiaries, and comprises certain covenants, notably regarding restrictions on the amount of capital assets which may be acquired.

Under the terms of the credit facility, the Company is required to maintain certain ratios, in particular, a leverage ratio, a debt/equity ratio and a fixed charge coverage ratio. As well, it is required to maintain a minimum level of tangible net worth. As at December 31, 1999, the Company has complied with these requirements.

An amount of $234.7 of this credit facility is hedged under a cross-currency interest rate swap in the amount of US$160.0.

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12. Long-term debt (continued)

An amount of $41.3 of this credit facility is used for letter of credit.

At December 31, 1999, the unused balance of the credit facility amounts to $34.0.

Other loans

Other loans are secured by movable and immovable hypothecs on certain assets of the subsidiaries.

Minimum payment requirements

Minimum payments requirements for the next five years amount to $48.2 in 2000, $56.2 in 2001, $110.6 in 2002, $265.2 in 2003 and $1.6 in 2004.

Interest

In 1999, the interest cost relating to the long-term debt amounted to $29.5 ($39.2 in 1998 and $20.0 in 1997).

Total interest paid in cash, net of interest income and including interest capitalized to property under construction, amounted to $31.8 in 1999 ($42.1 in 1998 and $24.2 in 1997).

13. Pension plans

Alliance Forest Products Inc. has several pension plans covering substantially all of its employees. The plan benefits are based primarily on years of service and each employee's highest average eligible earnings during any 60-month period. In the case of the American subsidiary, plan benefits are mostly based on the number of years of service credited since March 27, 1997 and the highest average eligible earnings during any 60-month period. Eligibility for certain benefits reflects years of service with Kimberly-Clark.

Employer contributions are made to the pension plans as needed in order to cover the cost of current services and deficit amortization. The Company's contributions can be reduced or be unnecessary during a given period if the pension plan assets exceed related liabilities. Actuarial reports are prepared annually by independent actuaries for accounting purposes. The following table details the pension expense for defined benefit pension plans for each year as well as the pension liability as at December 31.

Pension expense

	1999	1998	1997
Cost of services for the year	$9.2	$8.6	$5.4
Interest cost on projected benefit obligations	11.0	9.2	8.7
Return on assets	(9.7)	(8.6)	(7.9)
Amortization of past service costs	—	(0.3)	(0.1)
Pension expense for the year	$10.5	$8.9	$6.1

The pension expense and the obligation for pension benefits are actuarially determined using management's best estimated assumptions. For the Canadian plans, these include: a discount rate of 8.5% (for the three years) to calculate the present value of the projected benefit obligation; a long-term annual rate of wage increases for unionized and non-unionized employees of 2.0% (4.0% in 1998 and 1997) for the next five years and 4.0% thereafter to reflect the terms of the collective agreements.

For the American plans, these are based on the following assumptions for the past three years: a discount rate of 7.5% to calculate the projected obligation for employee pension benefits; a long-term rate of return on pension fund assets of 8.8%, long-term annual wage increases of 5% and a lower annual rate for the next five years to reflect the terms of the collective agreements.

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(In millions of Canadian dollars, unless otherwise indicated)

13. Pension plans (continued)

Capitalization of pension plans

	1999	1998
Pension plan assets, at market value	$130.3	$112.9
Actuarial value of projected benefit obligations	(148.5)	(127.4)
Unamortized balance of past service costs	2.5	(2.9)
Pension plan obligation	$(15.7)	$(17.4)

In the United States, the Company provides group health care and life insurance benefits to most retirees or their equivalents. Under an agreement reached with Kimberly-Clark, most employees over 55 years of age hired by U.S. Alliance Coosa Pines Corporation on March 27, 1997 will be entitled, upon retirement, to the benefits previously provided under the Kimberly-Clark group insurance plans.

Postretirement benefits and postretirement benefit obligations are determined using actuarial methods and assumptions. The cost of these benefits is charged to earnings as services are rendered by the employees. The projected postretirement benefit obligation amounts to $56.0 as at December 31, 1999 ($55.2 as at December 31, 1998).

In Canada, the Company provides group health care, life insurance and dental insurance benefits to certain retirees or their equivalents. The cost of providing these benefits is charged against earnings as incurred. The charges for the year amounts to $3.9 ($5.3 in 1998; $3.8 in 1997).

14. Capital stock

Authorized

Unlimited number of shares without nominal or par value
- Common shares
- First preferred shares
- Second preferred shares

Issued

Common shares

	1999		1998		1997	
	Number of shares		Number of shares		Number of shares	
Outstanding, beginning of year	38,176,267	$768.3	38,441,824	$773.7	17,422,172	$195.8
Shares issued						
For cash	—	—	—	—	20,987,500	577.2
Share purchase plans	72,335	1.1	32,943	0.6	20,534	0.5
Stock option plans	—	—	—	—	11,618	0.2
Share redemption	(3,045,851)	(61.3)	(298,500)	(6.0)	—	—
Outstanding, end of year	35,202,751	$708.1	38,176,267	$768.3	38,441,824	$773.7

During 1999, the Company redeemed and cancelled 3,045,851 common shares (298,500 in 1998 and nil in 1997) for $50.3 ($4.7 in 1998). The discount on the redemption of shares amounted to $11.0 ($1.3 in 1998) and was charged to the contributed surplus.

As at December 31,
(In millions of Canadian dollars, unless otherwise indicated)

14. Capital stock (continued)

Earnings per share are calculated using the weighted average number of common shares outstanding during the year, which amounted to 36,606,565 shares in 1999 (38,359,552 in 1998 and 33,539,345 in 1997).

On November 16, 1999, the Company adopted a share subscription plan that will be submitted for approval by the shareholders at the next annual meeting. A similar plan had been approved on April 26, 1995. In the event that a person or group announces his, her or its intention to acquire or acquires 20% or more of the Company's common shares, without first making an offer in accordance with certain criteria or obtaining approval from the Board of Directors while the subscription right system is in effect, subscription rights will be issued. Each right confers on its holder the right to acquire common shares of the Company for an amount equivalent to 50% of market value. The threat of a significant dilution should therefore result in changes to the offer so that it complies with certain criteria or should encourage negotiations with the Board of Directors.

Officers' stock option plan

The Company has a stock option plan for certain officers. These options generally expire ten years after they are granted and can be exercised immediately or progressively three or four years after they are granted.

	1999		1998		1997	
	Number of options	Weight average exercise price	Number of options	Weight average exercise price	Number of options	Weight average exercise price
Outstanding, beginning of year	2,515,303	$20.42	1,306,652	$24.60	898,723	$22.90
Granted	68,784	15.89	1,243,759	16.03	436,019	27.93
Exercised	—	—	—	—	(11,618)	17.00
Cancelled	(13,617)	17.00	(35,108)	21.06	(16,472)	25.20
Outstanding, end of year	2,570,470	$20.32	2,515,303	$20.42	1,306,652	$24.60

The following table summarizes information about the stock options outstanding at December 31, 1999:

	Number outstanding	Weighted average remaining contractual life	Weighted average exercise price	Number of exercisable options	Average weighted exercise price
Range of exercise prices					
$14.00 – $19.99	1,374,742	8	$15.06	296,764	$17.00
$20.00 – $24.99	386,406	4	23.73	197,582	23.77
$25.00 – $29.99	775,226	4	27.51	499,051	27.44
$30.00 – $35.00	34,096	7	34.06	3,334	32.96
	2,570,470			996,731	

15. Commitments

Supply agreements and leases

The Company has entered into various agreements, primarily for supply agreements, expiring on different dates up to 2034, that call for total payments of $299.9. Minimum payments for the next five years amount to $28.5 in 2000, $17.5 in 2001, $17.0 in 2002, $16.7 in 2003 and $16.4 in 2004.

Commitments for capital expenditures

In connection with its capital expenditures program, the Company has undertaken, under various contracts, to pay an amount of approximately $164.0, primarily to complete the construction of a paper machine in Donnacona.

Environment

The Company intends to comply with environmental regulations in the United States (Cluster Rules), as planned at the time of the acquisition. The Company estimates that it will spend approximately $53.0 to conform the current Coosa Pines installations to the American standards, i.e. $45.0 from now until January 2001 and $8.0 from now until January 2005.

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16. Financial instruments

Fair value of financial instruments

The fair value of the short-term investment, trade accounts receivable, bank indebtedness and accrued and trade accounts payable is comparable to their carrying amount given their relative short term to maturity.

The fair value of the investment in preferred shares is comparable to its carrying amount because it is practically impossible to find financial instruments on the market with essentially the same economic characteristics.

The fair value of long-term debt is determined by discounting future cash flows under these contracts using rates representing those which the Company would currently obtain for loans with similar terms, conditions and maturity dates. As at December 31, 1999 and 1998, the fair value of long-term debt is comparable to the carrying amount.

The fair value of the various derivative financial instruments is determined using market parameters.

The following table presents the fair value and the term of the Company's derivative financial instruments:

	1999					
	Reference amount					
	Less than one year	One to two years	Two to three years	Three to five years	Total	Fair value (CAN$)
Put options in U.S. dollars purchased	US$166.0	US$136.0	US$109.0	US$24.0	US$435.0	5.8
Call options in U.S. dollars sold	183.0	112.0	80.0	24.0	399.0	(7.5)
Cross-currency interest rate swaps	—	—	—	160.0	160.0	3.8

	1998					
	Reference amount					
	Less than one year	One to two years	Two to three years	Three to five years	Total	Fair value (CAN$)
Put options in U.S. dollars purchased	US$228.0	US$166.0	US$112.0	US$94.0	US$600.0	5.3
Call options in U.S. dollars sold	280.0	183.0	112.0	94.0	669.0	(68.4)
Cross-currency interest rate swaps	—	—	—	160.0	160.0	(10.1)

The fair value represents exchange gains or losses which would have been realized if the Company had sold all of its derivative financial instruments at December 31 each year, which is not the case.

17. Contingencies

Claims and lawsuits have been filed against the Company in the normal course of its operations. In management's opinion, there is generally adequate insurance coverage for these claims and lawsuits. In cases where coverage is inadequate, the outcome of the claims or lawsuits is not expected to substantially affect the Company's financial position.

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18. Segmented information

The Company has defined its segments based on its organizational structure. The paper segment includes newprint and uncoated groundwood specialty paper, the pulp segment includes fluff pulp and SBHK pulp while the lumber segment also includes treated wood and joists.

By industry segment	Paper			Pulp			Lumber		
	1999	1998	1997	1999	1998	1997	1999	1998	1997
Sales[a]	$526.4	$611.2	$441.2	$182.1	$176.0	$122.8	$344.2	$297.9	$259.3
Depreciation, amortization and depletion	53.0	49.3	30.5	12.3	9.6	13.1	25.7	29.3	16.8
Operating income (loss)	(32.6)	67.0	22.8	(5.8)	(16.9)	(4.5)	47.4	44.1	40.5
Capital expenditures	84.3	65.6	187.6	17.1	27.8	13.7	18.4	17.9	10.1
Assets	1,037.5	1,035.8	1,020.0	389.1	424.2	376.1	263.4	248.6	250.4

	Head office			Consolidated		
	1999	1998	1997	1999	1998	1997
Sales[a]	$—	$—	$—	$1,052.7	$1,085.1	$823.3
Depreciation, amortization and depletion	0.9	0.6	0.4	91.9	88.8	60.8
Operating income (loss)	—	—	—	9.0	94.2	58.8
Capital expenditures	0.8	3.1	2.7	120.6	114.4	214.1
Assets	44.4	63.2	42.4	1,734.4	1,771.8	1,688.9

(a) In 1999, transactions with one customer in the pulp segment represent 28.0% of sales (15.8% in 1998 and 14.8% in 1997). This same customer represents 28.0% of the Company's total accounts receivable (20.6% in 1998).

By geographic segment	1999	1998	1997
Sales			
Canada			
Canadian customers	$121.8	$119.9	$124.4
American customers	388.9	399.9	289.8
Overseas customers	9.7	2.2	7.3
	520.4	522.0	421.5
United States			
Canadian customers	6.3	11.8	5.3
American customers	483.4	490.2	358.4
Overseas customers	42.6	61.1	38.1
	532.3	563.1	401.8
Total	$1,052.7	$1,085.1	$823.3
Operating income			
Canada	$6.6	$53.1	$29.0
United States	2.4	41.1	29.8
	$9.0	$94.2	$58.8
Assets			
Canada	$783.6	$777.0	$745.9
United States	950.8	994.8	943.0
	$1,734.4	$1,771.8	$1,688.9

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19. Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. Although the change in date has occurred and there have not been any negative impacts for the Company to date, it is not possible to conclude that all aspects of the Year 2000 Issue that may affect the Company, including those related to customers, suppliers, or other third parties, have been fully resolved.

20. Subsequent event

On February 10, 2000, the Company sold substantially all of its timberlands for a cash consideration of approximately US$302.9. At the same time, the Company, entered into an agreement expiring on December 31, 2014, to purchase from the buyer, at market value, approximately 70% of the expected timber production over the next five years, i.e. 4,000,000 tonnes and approximately 30% of the expected production in the next ten years, i.e. 4,900,000 tonnes. Accordingly, the Company is guaranteeing a return on the buyer's investment for at least the first five years of the supply contract and will recognize the gain of approximately $120.0 on the sale of the timberlands over the same period.

On February 10, 2000, the Company also announced its intention to redeem $100.0 of its common shares for cancellation. The Company will redeem the shares using the modified Dutch auction method, which allows shareholders to offer some or all of their shares at a price within a pre-determined range. This offer expires on March 8, 2000.

21. Comparison of Canadian and United States generally accepted accounting principles

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada (Canadian GAAP). In certain respects, Canadian GAAP differ from generally accepted accounting principles in the United States (U.S. GAAP).

The following summary sets out the material adjustments to the Company's net earnings (loss) which would be made in order to conform with U.S. GAAP:

	1999	1998	1997
Net earnings adjustments			
Earnings (loss) before income taxes in accordance with Canadian GAAP	$(24.2)	$35.5	$38.2
Add (deduct)			
Unrealized exchange gains (losses)[(a)]	33.9	(17.8)	(13.0)
Unrealized exchange gains (losses) on foreign currency hedges[(b)]	61.4	(31.5)	(30.0)
Postretirement benefits other than pensions[(c)]	(0.3)	(0.2)	(0.2)
Pension costs[(d)]	(4.7)	(2.2)	—
Earnings (loss) before income taxes in accordance with U.S. GAAP	66.1	(16.2)	(5.0)
Income taxes in accordance with Canadian GAAP	(8.0)	9.6	11.7
Add (deduct)			
Income tax on above adjustments	30.7	(17.3)	(13.2)
Adjustment required under the liability method[(e)]	—	—	1.1
Income tax related to May 12, 1994 acquisition[(e)]	1.6	2.2	2.9
Income taxes in accordance with U.S. GAAP	24.3	(5.5)	2.5
Net earnings (loss) in accordance with U.S. GAAP	41.8	(10.7)	(7.5)
Net earnings (loss) per common share in accordance with U.S. GAAP	$1.14	$(0.28)	$(0.22)

As at December 31,
(In millions of Canadian dollars, unless otherwise indicated)

21. Comparison of Canadian and United States generally accepted accounting principles (continued)

The following summary sets out the material differences in the Company's balance sheet under accounting principles generally accepted in Canada and in the United States:

	1999		
	Canadian GAAP	Adjustments	U.S. GAAP
Balance sheet components			
Other assets[a]	$71.3	$(0.4)	$70.9
Trade and other accounts payable[b]	190.8	1.7	192.5
Pension liability and postretirement benefits obligation[c][d]	71.7	(1.3)	70.4
Deferred income taxes[e]	41.8	(9.3)	32.5
Shareholders' equity[a][b][c][d][e]	$892.4	$8.5	$900.9

	1998		
	Canadian GAAP	Adjustments	U.S. GAAP
Balance sheet components			
Other assets[a]	$89.7	$(30.8)	$58.9
Trade and other accounts payable[b]	126.1	63.1	189.2
Pension liability and postretirement benefits obligation[c][d]	72.6	(6.3)	66.3
Deferred income taxes[e]	47.4	(38.1)	9.3
Shareholders' equity[a][b][c][d][e]	$957.8	$(49.5)	$908.3

(a) Unrealized exchange gains and losses attributable to the translation of long-term debt in a foreign currency and cross-currency interest rate swaps, at rates in effect at the balance sheet date, are deferred and amortized over the remaining life of these financial instruments. Under U.S. GAAP, these gains and losses are charged to earnings.

(b) Under Canadian GAAP, unrealized exchange gains and losses on long-term derivative financial instruments designated to hedge future income are recognized when the contracts expire. Under U.S. GAAP, such gains and losses are charged to earnings as though the Company had realized these contracts at year-end.

(c) Under Canadian GAAP, certain postretirement benefits other than pensions are accounted for on a "pay-as-you-go" basis. Under U.S. GAAP, these postretirement benefits are accounted for on an accrual basis.

The details of the accumulated postretirement benefits obligation other than pensions are as follows:

	1999	1998
Retirees	$6.1	$4.9
Active employees – fully eligible	14.5	17.6
Other active employees	32.0	39.9
	52.6	62.4
Unrecognized gain (loss)	9.8	(1.2)
Accumulated postretirement benefits obligation	$62.4	$61.2

As at December 31,
(In millions of Canadian dollars, unless otherwise indicated)

21. Comparison of Canadian and United States generally accepted accounting principles (continued)

In Canada, for measurement purposes, in 1999 and 1998 a 10.5% (11.5% in 1997) annual rate of increase in per capita cost of covered health care benefits was assumed for the year following the valuation date; the rate was then assumed to decrease by 0.5% per year to 4.5% for 1999 and 1998 (5.5% in 1997) and to remain at this level thereafter. For measurement purposes, in 1999 and 1998, a 4.5% (5.5% in 1997) annual rate of increase in per capita cost of covered dental care benefits was assumed.

The Company uses average compensation growth and discount rate assumptions to estimate its accumulated postretirement benefits obligation. These rates were 3.0% and 5.75% for 1999 (4.0% and 7.5% for 1998 and 1997).

In the United States, for measurement purposes, a 7.0% (8.0% in 1998 and 1997) annual rate of increase in per capita cost of covered health care benefits was assumed for the year following the valuation date; the rate was then assumed to decrease by 1% per year to 6% and to remain at this level thereafter. The Company uses average compensation growth and discount rate assumptions to estimate its accumulated postretirement benefits obligation. These rates were 5.0% and 7.75% respectively as at December 31, 1999 (5.0% and 7.25% in 1998 and 1997).

(d) Under U.S. GAAP, the rate used for discounting pension benefit obligations is the rate at which pension benefits could currently be settled. The rate used under Canadian GAAP is based on management's best estimate of the future return on the plan assets over the expected duration of the plan.

(e) Under U.S. GAAP, the Company is required to use the liability method versus the deferral method prescribed under Canadian GAAP. The liability method requires the recognition of changes in statutory tax rates.

On May 12, 1994, the Company acquired Domtar Inc. newsprint, uncoated groundwood paper and related lumber operations. The tax values of the assets and liabilities acquired were different from the book value. Under U.S. GAAP a deferred tax asset of $32.0 would have been recorded initially and subsequently reduced through amortization.

(f) Under Canadian GAAP, share issuance expenses are charged directly to retained earnings. Under U.S. GAAP, these expenses are deducted from the related proceeds, with the net proceeds being recorded in the capital stock account.

(g) Under U.S. GAAP, the Company has elected to continue to measure compensation costs related to awards of stock options using the intrinsic value based method of accounting. In this instance, however, under Statement of Financial Accounting Standards (SFAS) No. 123 "Accounting for Stock-Based Compensation", the Company is required to make pro forma disclosures of net earnings and earnings per share as if the fair-value-based method of accounting had been applied. The fair value of options granted was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions: risk-free interest rate of 5.1% (5.3% in 1998 and 5.8% in 1997) expected life of six years for the three years and volatility of 30.0% (34.0% in 1998 and 28.0% in 1997).

Accordingly, the Company's net loss and net loss per share for the year ended December 31, 1999 would have been increased, on a pro forma basis, by $4.7 and $0.13 respectively (decrease of net earnings and net earnings per share of $5.6 and $0.14 respectively for 1998 and $2.8 and $0.08 respectively for 1997). The weighted average fair value of options granted in 1999 was $6.51 ($6.95 in 1998 and $11.13 in 1997).

(h) Under Canadian GAAP, distribution costs, which include freight, commissions and discounts, are deducted from revenues in arriving at the net sales. Under U.S. GAAP, commissions and freight costs should not be presented as deductions from sales but rather should be treated as operating expenses. If this presentation had been adopted, net sales and operating expenses would have increased by $96.5 in 1999 ($97.9 in 1998 and $79.3 in 1997). This difference in presentation would have had no effect on operating income and net earnings.

(i) The FASB has issued SFAS No. 133 "Accounting for Derivative Instruments for Hedging Activities", which is effective for the fiscal years beginning after June 15, 2000. The Company has not yet determined the possible repercussions of this new standard.

Financial retrospective

For years ended December 31
(Unaudited)
(in millions of dollars, except amounts per share and statistics)

	1999	1998	1997	1996	1995
Data related to statements of earnings					
Sales					
Paper	$526.4	$611.2	$441.2	$257.2	$287.8
Pulp	182.1	176.0	122.8	—	—
Lumber	344.2	297.9	259.3	166.8	114.2
	1,052.7	1,085.1	823.3	424.0	402.0
Operating costs and expenses					
Cost of goods sold	914.0	864.2	678.3	298.4	253.7
Selling, general and administrative expenses	37.8	37.9	25.4	21.4	21.4
Depreciation, amortization and depletion	91.9	88.8	60.8	22.2	16.4
	1,043.7	990.9	764.5	342.0	291.5
Operating income (loss)					
Paper	(32.6)	67.0	22.8	51.7	99.2
Pulp	(5.8)	(16.9)	(4.5)	—	—
Lumber	47.4	44.1	40.5	30.6	12.0
Head office	—	—	—	(0.3)	(0.7)
	9.0	94.2	58.8	82.0	110.5
Net financing expenses (revenues)	33.2	58.7	20.6	1.5	(0.7)
Net earnings (loss)	(16.2)	25.9	26.5	56.0	81.2
Net earnings (loss) per common share	(0.44)	0.68	0.79	3.21	4.56
Shares outstanding, end of year (in thousands)	35,203	38,176	38,442	17,422	17,504
Data related to statements of changes in cash resources[1]					
Working capital provided by operations	71.2	155.1	104.9	96.5	107.7
Changes in non-cash working capital items	51.6	(25.0)	(31.3)	(21.1)	(4.6)
Disposition (acquisition) of commercial activities	60.0	—	(837.8)	—	(77.0)
Capital expenditures	(120.6)	(114.4)	(214.1)	157.1	49.1
Increase (reduction) of long-term debt	(44.2)	13.6	457.8	28.0	(0.2)
Issue of common shares	1.1	0.6	550.0	0.5	0.3
Redemption of shares	(50.3)	(4.7)	—	(2.4)	(9.2)
Increase (decrease) in cash	5.8	—	—	(33.0)	(36.7)
Data related to balance sheet (at December 31)					
Current assets	296.0	312.4	274.2	144.1	138.0
Capital assets	1,367.1	1,369.7	1,346.7	365.6	229.3
Total assets	1,734.4	1,771.8	1,688.9	552.8	411.8
Current liabilities	291.9	177.3	200.5	115.5	80.6
Long-term debt	436.6	516.7	455.9	40.8	11.4
Shareholder's equity	892.4	957.8	936.0	350.6	296.5
Book value per common share (in dollars)	25.35	25.09	24.35	20.12	16.94
Production statistics					
Newsprint (thousands of tonnes)	455	416	381	184	194
Uncoated Groundwood paper (thousands of tonnes)	227	222	201	132	134
Soft-nip calendered paper (thousands of tonnes)	95	107	20	—	—
Market pulp (thousands of tonnes)	262	259	192	—	—
Lumber (millions of fbm)	656	646	579	487	353
Treated lumber (millions of fbm)	25	21	32	25	11
I-joists (millions of linear feet)	24	16	9	—	—

[1] 1996 and 1995 numbers have not been adjusted to new accounting principles implemented in 1999.

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Chairman of the Board, Alliance Forest Products Inc. (Québec City)

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2 Member of the Executive Compensation Committee
3 Member of the Nomination and Corporate Governance Committee
4 Member of the Pension Management Committee

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Information for shareholders and investors

Annual meeting
The Annual General Meeting for shareholders will be held in Montréal, in the Grand salon of the Queen Elizabeth Hotel, on Thursday, April 20, 2000, at 11:00 a.m.

Stock exchange listings
Alliance Forest Products Inc. common shares are listed on the Toronto Stock Exchange under the symbol ALP and on the New York Stock Exchange under the symbol PFA.

Alliance Forest Products Inc. is one of the TSE 300 companies.

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Montreal Trust Company
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